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**Via Overnight Mail**

**RECEIVED**

May 25, 2004

**MAY 26 2004**

**PUBLIC SERVICE  
COMMISSION**

Thomas M. Dorman, Esq.  
Executive Director  
Kentucky Public Service Commission  
211 Sower Boulevard  
Frankfort, Kentucky 40602

***Re:*        Case No. 2003-00165**

Dear Mr. Dorman:

Please find enclosed the original and twelve (12) copies of Kentucky Industrial Utility Customers, Inc. Response to Kenergy's Corporation's Application for Rehearing filed in the above-referenced matter.

By copy of this letter, all parties listed on the attached Certificate of Service have been served. Please place these documents of file.

Very Truly Yours,



Michael L. Kurtz, Esq.

**BOEHM, KURTZ & LOWRY**

MLK:ew  
Attachment  
Cc: Richard G. Raff, Esq., (via electronic mail)

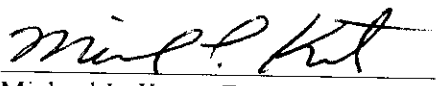
### CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served by mailing a true and correct copy, by regular U.S. mail (unless otherwise noted) to all parties on this 25<sup>th</sup> day of May, 2004.

Honorable Elizabeth E. Blackford  
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Office of the Attorney General  
Utility & Rate Intervention Division  
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Honorable Frank N. King, Jr.  
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Dean Stanley  
President And CEO  
Kenergy Corporation  
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Owensboro, KY 42302

  
Michael L. Kurtz, Esq.

**BEFORE THE  
KENTUCKY PUBLIC SERVICE COMMISSION**

**In The Matter Of: The Application Of Kenergy       :**  
**Corp. For A Review And Approval of Existing       :**       **Case No. 2003-00165**  
**Rates   :**

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**KENTUCKY INDUSTRIAL UTILITY CUSTOMER'S  
RESPONSE TO KENERGY CORP.'S  
APPLICATION FOR REHEARING**

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On April 22, 2004 the Kentucky Public Service Commission ("the Commission") issued its Order in the above-captioned matter. On May 14, 2004, Kenergy Corp. ("Kenergy" or "the Company") filed its "Application For Clarification Or, Alternatively, For Rehearing" requesting that the Commission (1) delete its requirement that all customers are required to participate in the rider extension or reduction, apparently for the purpose of excluding KIUC members from any resultant rate reduction; (2) clarify that Kenergy is not precluded from making a tariff filing requesting an extension of the consolidation credit rider (3) stay the Commission's April 22, 2004 Order due to a de minimis error in the pro forma adjustments.

For the reasons set out below Kentucky Industrial Utility Customers, Inc. ("KIUC") asks the Commission to deny the Company's request.

**1.   The Company's Request That The Commission Modify Its Order To Delete The Requirement That All Customers Participate In The Future Rate Adjustment Is Unjust And Unreasonable.**

The Company requests that the Commission amend its requirement that all Kenergy customers should benefit from the rate decrease that will result when Kenergy files its application to extend the

consolidation credit rider or propose an alternative methodology. The Company argues that there is no evidence in the record to support the inclusion of all customers in this future rate adjustment. Specifically, the Company contends that the KIUC members should not benefit from the rate adjustment due to reductions they received in this case and in Case No. 2000-00395. Finally, the Company believes that the Commission has “predetermined” the issue of the allocation of a future rate decrease by ordering that all customers be included in the adjustment that results from the Company’s prospective filing.

The Company’s argument that there is no evidence to support a rate adjustment for all Kenergy customers flies in the face of its own testimony introduced in this case, and its assertion that KIUC members in particular should not receive a reduction is incongruous. The evidence clearly shows that of all Kenergy customers, KIUC members as well as the three-phase commercial and industrial customers are entitled to a rate deduction. In its Order the Commission rightly noted that Kenergy’s cost of service evidence shows that direct-serve and three-phase commercial and industrial customers are paying rates greatly in excess of cost of service. The Commission states:

*“Kenergy filed a detailed cost-of-service study that showed that the revenues from the direct-serve customers exceed their cost of service. The study also showed that the revenues from the non-direct, three phase commercial and industrial customers exceed their cost of service, while the revenues from the single phase and residential customers are insufficient to cover their cost of service. Despite this study, Kenergy proposed no adjustment to any of its rates.”<sup>1</sup>*

The Commission language cited above reflects the evidence presented in Case No. 2003-00165 that all customers of Kenergy are paying revenues that are out of kilter with their related cost of service. As the Commission noted, Kenergy’s reluctance to propose any adjustment in rates arises from its “five year promise” to its customers. That five year promise and the related consolidation credit rider both will expire on September 2, 2004. Thus, the Commission’s directive (to either extend the rider to all customers or find an alternative methodology to pass the increase in earnings to all ratepayers) manifests

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<sup>1</sup> KPSC Case No. 2003-00165, Order of April 22, 2004 at 16.

the Commission's recognition that (1) the burden of revenues should be more fairly allocated among customers and customer classes, and (2) that the expiration of the five year promise provides an appropriate window of opportunity to re-calibrate rates and the allocation of revenue burden to better reflect cost of service.

In particular, Kenergy objects to the Commission directive to propose rate adjustments to all customers because Kenergy seeks to exclude the KIUC Members from any further rate adjustment. Kenergy's purported rationale for such exclusion is that the KIUC Members have received aggregate annual revenue reductions of \$400,000 in this case and Kenergy's immediately preceding rate case. The Commission's rate reductions to KIUC customers in this case and in Case No. 2000-00395 were in response to extreme adverse treatment of KIUC members from a cost of service perspective. KIUC members continue to pay rates greatly in excess of cost of service, while residential customers continue to be subsidized despite these prior reductions. Kenergy's own cost of service data in Case No. 2003-00165 shows that its annual distribution costs of serving the KIUC Members is \$343,461. Prior to the Commission's decision in the preceding Kenergy rate case, Case No. 2000-00395, the KIUC Members paid approximately \$1,078,000 in annual distribution fees to Kenergy, more than triple the distribution related cost of service.

With the \$400,000 in revenue reductions to the KIUC Members ordered by the Commission in Case No. 2000-00395 and Case No. 2003-00165, the KIUC Members now pay approximately \$678,000 in annual distribution fees to Kenergy, which is still about double the related cost of service. In essence, while Kenergy asserts that the KIUC Members have been given preferential treatment and should not be accorded any further rate adjustments, the reality of the situation is that the distribution fees charged to the KIUC Members have been reduced from 314% of related distribution costs to 197% of related distribution costs.

The nexus between cost of service and what is a “just and reasonable rate” is well established. In its Main Brief, KIUC cited numerous orders of this Commission and other state commissions, as well as expert treatises, for the proposition that cost of service should be the primary consideration in setting rates.<sup>2</sup> Further, KIUC submitted testimony showing that low industrial electric rates are vitally important to ensuring the growth of the Kentucky economy, and in particular that energy-intensive industries such as aluminum and paper production can realistically only survive in States with low electric rates.<sup>3</sup> Given Kenergy’s own cost of service study which shows that KIUC customers continue to pay rates greatly in excess of cost of service, the near universal view among regulatory agencies and experts that rates should be primarily based on cost-causation, and KIUC testimony regarding the numerous positive effects that low industrial rates have on Kentucky’s economy, the Company’s argument that there is no evidence to support a rate reduction for KIUC members is baseless.

The Company’s argument that the Commission not “predetermine” the allocation of reductions that will likely result from its impending application is inside-out. It is the Company that is seeking to predetermine this issue by excluding KIUC from future reductions. The proper level of future rates for all ratepayers is best left for the next case.

2. **Kenergy’s Intention To Extend The Consolidation Credit Rider And Thereby Forestall The Express Intention Of The Commission That Rates And Revenues Be Realigned Should Not Be Countenanced By The Commission.**

Kenergy’s request for clarification of the Commission’s language concerning the continuance of the consolidation credit rider is an attempt to circumvent the Commission’s directive for Kenergy to file an application for the express purpose of realigning rates and the associated revenue burden in a manner that more closely reflects associated cost of service. In essence, Kenergy is asking whether it may (1) file an application prior to September 2, 2004, that would not reflect a realignment of existing rates, but would only seek to extend the consolidation credit rider that would otherwise expire on September 2,

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<sup>2</sup> KIUC Main Brief pp. 7-8.

<sup>3</sup> Id. at 16-18.

2004; and (2) then file a second application on or before December 31, 2004 that would satisfy the Commission directive for Kenergy to begin to address the disparity between rates and cost of service.

The Commission should make clear to Kenergy that it will not grant an extension of the consolidation credit rider. First and foremost, the evidence provided in Case No. 2003-00165 does not support any such extension. Kenergy's own testimony in Case No. 2003-00165 supported the proposition that upon expiration on September 2, 2004, of the consolidation credit rider, the rates and cost of service for residential customers would be much more closely aligned. Any extension of the consolidation credit rider would allow the significant disparity between rates and cost of service for all customers to continue for up to an additional ten months.

The Commission's Order in Case No. 2003-00165 specifically provides that the mandated application by Kenergy may rely upon the cost of service study filed in Case No. 2003-00165, which has already been scrutinized by the Commission. After adjustments to disallow certain expenses, the Commission has made a regulatory determination of the appropriate revenue requirement applicable to Kenergy. Thus, without performing any further research or studies, Kenergy already has all of the information necessary to prepare and file the application for rate realignment as ordered by the Commission.

The Commission should not allow Kenergy to extend the consolidation credit rider and thereby forestall the express intention of the Commission that rates and revenues be realigned.

3. **The Revenue Reductions Awarded To KIUC Members Should Not Be Stayed Due To A De Minimis Accounting Error.**

Kenergy asserts that the Commission has made a computational error of \$53,793 in its calculation of the operating revenue decrease, and asks that the Commission correct this error. Kenergy also asks that the Commission's Order of April 22, 2004 be stayed pending this correction. Moreover, Kenergy asserts that if it is determined that the Commission erred in its determination of the operating

revenue decrease, then the revenue reduction accorded to the KIUC Members should be correspondingly modified.

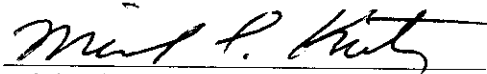
KIUC objects to Kenergy's request. As the Commission is aware, the question of the appropriate distribution rates for KIUC Members is an issue that has been before the Commission since Case No. 99-162. Kenergy has failed to submit information that the Commission has directed Kenergy to file, and Kenergy has sought extensions of time in its efforts to submit information or initiate proceedings in response to Commission directives. The Commission has previously denied such extensions on the basis that further deferrals of time before rates will be adjusted would not be reasonable. The further extension of time sought by Kenergy's latest motion is similarly unwarranted, and should be denied.

Moreover, even if it is eventually determined that an error exists in the computations performed by the Commission, the amount of the revenue reduction accorded to the KIUC Members is justified by the record in Case No. 2003-00165. In this proceeding, KIUC sought revenue reductions of \$496,874 based on adherence to cost of service principles, but was awarded a revenue reduction of only \$162,347. As set forth earlier, the distribution fees paid by the KIUC Members is approximately twice the related cost of service. Fairness in the rate making process dictates that the revenue reduction awarded to the KIUC Members should not be stayed or modified due to a de minimis computational mistake. This de minimis error should be considered, if at all, when the Commission takes up the issue of how the \$2.5 million rate decrease should be allocated when the consolidation credit rider expires in just over three months. Surely Kenergy can absorb a \$53,793 revenue deficiency within a \$2.5 million revenue surplus, at least on a temporary basis.



WHEREFORE, for the reasons set forth above, KIUC respectfully requests that the Commission deny the Company's request for clarification and/or rehearing.

Respectfully submitted,



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Kurt J. Boehm, Esq.

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May 24, 2004